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Douglas D. Orvis II  
Kimberly A. Lacey  
douglas.orvis@bingham.com  
kimberly.lacey@bingham.com

December 2, 2010

**By Hand Delivery**

Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12th Street, SW  
Washington, DC 20554

**FILED/ACCEPTED**  
**DEC - 2 2010**  
Federal Communications Commission  
Office of the Secretary

**Re: In the Matter of Request for Review of Decision of the  
Universal Service Administrator by Consolidated  
Communications Fort Bend Company, Illinois Consolidated  
Telephone Company, and Consolidated Communications of  
Texas Company, WC Docket No. 05-337**

Dear Secretary Dortch:

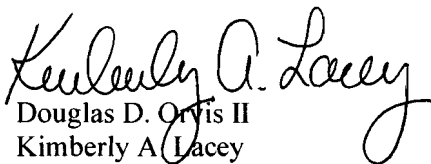
On behalf of Consolidated Communications Fort Bend Company, Illinois Consolidated Telephone Company, and Consolidated Communications of Texas Company (collectively, the "Companies"), please find attached a redacted, public version of Companies' Request for Review of Universal Service Administrator Decision in WC Docket No. 05-337 ("Request"). The attached Request has been marked "**REDACTED - FOR PUBLIC INSPECTION.**"

The Companies are also submitting, under separate cover, a confidential version of this Request. The confidential version is marked "**CONFIDENTIAL - NOT FOR PUBLIC INSPECTION.**"

An original and four (4) copies of this Request are enclosed. Please date-stamp one copy of this filing and return it in the envelope provided.

Should you have any questions please do not hesitate to contact us.

Respectfully submitted,

  
Douglas D. Orvis II  
Kimberly A. Lacey

Boston  
Hartford  
Hong Kong  
London  
Los Angeles  
New York  
Orange County  
San Francisco  
Santa Monica  
Silicon Valley  
Tokyo  
Walnut Creek  
Washington

Bingham McCutchen LLP  
2020 K Street NW  
Washington, DC  
20006-1806

T 202.373.6000  
F 202.373.6001  
bingham.com

A/73577571.1

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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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	)	
Request for Review of Decision of the	)	
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Consolidated Communications of Fort Bend	)	WC Docket No. 05-337
Company, Illinois Consolidated	)	
Telephone Company, and Consolidated	)	
Communications of Texas Company	)	

**REQUEST FOR REVIEW OF DECISION OF THE UNIVERSAL SERVICE  
ADMINISTRATOR BY CONSOLIDATED COMMUNICATIONS OF FORT BEND  
COMPANY, ILLINOIS CONSOLIDATED TELEPHONE COMPANY, AND  
CONSOLIDATED COMMUNICATIONS OF TEXAS COMPANY**

Douglas D. Orvis II, Esq.  
Kimberly A. Lacey, Esq.  
BINGHAM MCCUTCHEN, LLP  
2020 K Street, N.W.  
Washington, D.C. 20006  
Tel: (202) 373-6000  
Fax: (202) 373-6001  
Email: douglas.orvis@bingham.com

Dated: December 2, 2010

## **REDACTED - FOR PUBLIC INSPECTION**

### **SUMMARY**

Consolidated Communications of Fort Bend Company ("Fort Bend") (SAC No. 442072), Illinois Consolidated Telephone Company ("ICTC") (SAC No. 341037) and Consolidated Communications of Texas Company ("TXU") (SAC No. 442109), through their undersigned counsel, hereby requests review and revision of certain portions of the performance audits of the Universal Service Administrative Company ("USAC") received on October 4, 2010.

Fort Bend, ICTC and TXU are all ultimately owned by Consolidated Communications Holdings, Inc. ("Consolidated") and receive funds from USAC's High Cost Program, including High Cost Loop ("HCL"), Local Switching Support ("LSS") and Interstate Common Line Support ("ICLS"). Consolidated contends that USAC's outside auditors made several errors and incorrect conclusions as part of their audit of Fort Bend, ICTC and TXU. Specifically, the auditors applied the incorrect documentation retention requirements, improperly attempted to impose a category freeze on ICTC, erred in their application of Part 64 to tax reconciliation and incorrectly held that ICTC's allocations between regulated and unregulated expenses were improper.

Consolidated respectfully requests that the Wireline Competition Bureau ("Bureau") reverse the incorrect portions of the audits identified in this request, and direct USAC to improve future audits. Consolidated also reserves its right to further appeal the portions of the audits that were stayed pending USAC's request for further clarification from the Federal Communications Commission ("FCC" or "Commission").

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ADMINISTRATOR BY CONSOLIDATED COMMUNICATIONS OF FORT BEND  
COMPANY, ILLINOIS CONSOLIDATED TELEPHONE COMPANY, AND  
CONSOLIDATED COMMUNICATIONS OF TEXAS COMPANY**

**I. INTRODUCTION AND SUMMARY**

Consolidated Communications of Fort Bend Company ("Fort Bend") (SAC No. 442072), Illinois Consolidated Telephone Company ("ICTC") (SAC No. 341037) and Consolidated Communications of Texas Company ("TXU") (SAC No. 442109), through their undersigned counsel, hereby requests review and revision of certain portions of the performance audits of the Universal Service Administrative Company ("USAC") received on October 4, 2010.<sup>1</sup>

Fort Bend, ICTC and TXU are all ultimately owned by Consolidated Communications Holdings, Inc. ("Consolidated") and receive funds from USAC's High Cost Program, including High Cost Loop ("HCL"), Local Switching Support ("LSS") and Interstate Common Line Support ("ICLS"). Consolidated acquired ICTC in 2002 ("ICTC Acquisition") and completed its

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<sup>1</sup> Consolidated Communications of Fort Bend Company Follow -Up Audit No. HC-2009-FL-069, Performance audit for the Universal Service Fund disbursements made during the twelve-month period ended June 30, 2007 ("Fort Bend Audit Report"); Illinois Consolidated Telephone Company Follow-up Audit No. HC-2009-FL-080, Performance audit for the Universal Service Fund disbursements made during the twelve-month period ended June 30, 2007 ("ICTC Audit Report"); Consolidated Communications of Texas Company (formerly TXU Communications Telephone Company) Follow-up Audit No. HC-2009-FL-099 ("TXU Audit Report"). The Fort Bend Audit Report is attached hereto as Confidential Exhibit A; the ICTC Audit Report is attached hereto as Confidential Exhibit B; the TXU Audit Report is attached hereto as Confidential Exhibit C.

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acquisition of Fort Bend and TXU in 2004 (“TX Acquisition”) (collectively, “Acquisitions”). These three affiliates were subject to an audit under the Office of Inspector General’s (“OIG”) Audit program, supervised by USAC, and conducted by auditors from the firm KPMG LLP (“Auditors”). As part of the audit proceedings, the Auditors conducted a site visit at Consolidated’s offices and reviewed various documentation and records. The performance audit reports issued by the Auditors were reviewed by USAC, which issued its Management Response in August. The audit reports were finalized by USAC and received by the companies on October 4, 2010. The final audit reports contain various incorrect and erroneous factual statements and legal conclusions. As detailed below, Consolidated requests review and reversal of the following findings on behalf of its subsidiaries ICTC, Fort Bend and TXU.

### **II. APPEAL OF DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR**

#### **A. The Auditors Erred by Indefinitely Extending the Record Retention Requirements.**

##### **i USAC’s Auditors May Not Indefinitely Extend Record Retention Requirements.**

The Auditors concluded that ICTC, Fort Bend and TXU each lacked support for assets that have long been in service, well after the expiration of the Commission’s record retention requirement, to the extent that any such requirement even applies to these assets (ICTC Audit Finding No. 2, Fort Bend Audit Finding No. 1 and TXU Audit Finding No. 1). The conclusions reached in each of these findings regarding lack of support for assets must all be reversed by the Wireline Competition Bureau (“Bureau”) as improper and contrary to Commission rules and regulations. As explained in greater detail below, much of the information sought by the Auditors is extremely old and exceeds all USF record retention requirements. Further, the application of record retention rules to high-cost recipients prior to 2008 is under review by the

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Commission.<sup>2</sup> As such, while Consolidated sets forth the following objections to these findings, it also reserves its right to make further appeals after the FCC has issued its response to USAC's request for guidance on these issues.<sup>3</sup>

Telecommunications carriers are not required to maintain documents and records indefinitely. Under rules enacted in 2008, the FCC requires USF funding recipients to maintain appropriate documentation for five years and NECA recommends that members retain documentation for an additional two years.<sup>4</sup> Based upon the FCC and NECA guidelines, it is Consolidated's policy to retain vendor invoices and related documentation for a total of seven years. Seven years of document retention is a reasonable practice and also comports with the IRS requirements for tax records.<sup>5</sup> Yet, USAC's Auditors penalized Consolidated for failing to maintain records for assets put into service over 15 or even 20 years ago by a predecessor company. As detailed in the attached Confidential Exhibit D, the assets that USAC Auditors identified as lacking sufficient documentation were originally funded, acquired and put into service from 1990 to 2003. With the exception of one item, all of the assets for which USAC seeks recovery were put into service more than seven years prior to the USAC audit.<sup>6</sup> As such, Consolidated was not obligated by either the FCC rules or NECA guidelines to retain documentation on those assets.

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<sup>2</sup> *Comprehensive Review of the Universal Service Fund Management, Administration and Oversight*, Report and Order, 22 FCC Rcd 16372 (2007) ("USF Order").

<sup>3</sup> Consolidated further notes that the monetary effect of these findings were stayed pending a USAC request for further clarification from the Commission on the effect of the acquisition of these entities by Consolidated. (See, e.g., Fort Bend Audit Report, USAC Management Response, at 1; ICTC Audit Report, USAC Management Response, at 1; TXU Audit Report, USAC Management Response at 1.) Until such time as the Commission rules on this request from USAC, that issue is not ripe for appeal by Consolidated. As such, Consolidated reserves the right to appeal that decision after a decision is rendered, at a future date.

<sup>4</sup> Letter from NECA to General Contacts at All Member Companies (Feb. 22, 2008) (recommending the retention of records for seven years) ("NECA Letter"). A copy of the NECA Letter is attached hereto as Exhibit E.

<sup>5</sup> Internal Revenue Service, Publication 583, *Starting a Business and Keeping Records*, at 15 (Jan. 2007).

<sup>6</sup> The Buried Cable included in the TXU audit was put into service in October 2003. See Confidential Exhibit D. While this asset was put into service only 6 1/2 years before USAC's audit, its acquisition was still more than five years prior to the audit and as such outside of any FCC record retention requirements. Even so, USAC auditors found that Consolidated provided partial record support to this asset.

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It is unrealistic and unduly burdensome to require USF recipients to retain documentation into perpetuity. Record retention regulations exist to establish a reasonable time period throughout which businesses must retain documentation, and to provide a cut-off after which those businesses may then dispose of the documentation. USAC's Auditors should not be allowed to disregard these well-established rules and arbitrarily require recipients to retain all documentation for all assets without end. The Bureau must reverse any USAC decision that has the practical effect of extending document retention requirements indefinitely.

### **ii The Current Record Retention Requirements Do Not Apply to Assets Acquired Prior to January 2008.**

In 2007, the Commission adopted Section 54.202(e), which established a five year record retention requirement for documentation related to the use of monies from the universal service high-cost fund.<sup>7</sup> The rule became effective on January 23, 2008,<sup>8</sup> but the Commission did not explain whether, or how, the rule applied to the use of funding prior to its effective date. USAC itself has sought clarification of the application of this rule stating that “[a]lthough the Commission established High Cost Program documentation retention rules applicable on a prospective basis, the Commission did not address audits and the results of audits prior to the establishment of the documentation rules.”<sup>9</sup>

First, Consolidated agrees with the many companies that commented on USAC's request for guidance, that this rule may not be applied retroactively.<sup>10</sup> There is no evidence in the record

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<sup>7</sup> 47 C.F.R. § 54.202(e).

<sup>8</sup> 73 Fed. Reg. 11837 (March 5, 2008).

<sup>9</sup> See Letter from Richard A. Belden, Chief Operating Officer, USAC to Ms. Julie Veach, Acting Chief, Wireline Competition Bureau, FCC, at 3 (Aug. 19, 2009) (“USAC Letter”).

<sup>10</sup> See e.g. Comments of The United States Telecom Association, Request for Universal Service Fund Policy Guidance by the Universal Service Administrative Company, CC Docket No. 96-45, WC Docket Nos. 05-337, 06-122 (filed Oct. 28, 2009); Comments of Qwest Communications International, Inc., Request for Universal Service Fund Policy Guidance by the Universal Service Administrative Company, CC Docket No. 96-45, WC Docket Nos. 05-337, 06-122 (filed Oct. 28, 2009); Comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies and Western Telecommunications Alliance, Request for Universal Service Fund

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or the Commission's order to support a retroactive application of these record retention requirements. Also, it would be patently unfair and improper to evaluate a carrier's documentation of high-cost expenditures based upon rules that were not in effect at the time the asserts were purchased or even in existence during the time period subject to audit. Yet, by applying Section 54.202(e) to the audits and its review of Consolidated's records, USAC's Auditors are retroactively applying the Commission's order. Such actions are improper and must be reversed.

Furthermore, even if the five year record retention requirement applies to Consolidated's expenditures, the acquisition of these assets significantly predates the five year time limit. In adopting five years as an appropriate record retention time period, the Commission based its requirement on the presumption that audits would take place within five years of the disbursement of the support used to make those expenditures as required by the statute of limitations.<sup>11</sup> For the matter at hand, the expenditures clearly occurred more than five years before the disbursements that are the subject of the Audit. For example, the Fort Bend Audit Report found there was no documentation for an underground conduit put into service in 1990.<sup>12</sup> Clearly, the funding for this underground conduit was made almost 20 years ago, which far exceeds the five year requirement for retaining documents. Consolidated respectfully urges the Bureau to clarify the application of Section 54.2025(e) and ensure it is not improperly applied retroactively.

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Policy Guidance by the Universal Service Administrative Company, CC Docket No. 96-45, WC Docket Nos. 05-337, 06-122 (filed Oct. 28, 2009).

<sup>11</sup> USF Order, ¶ 24, n.71 (2007).

<sup>12</sup> Ford Bend Audit Report at Finding No. 1, p. 12; *see also* Confidential Exhibit D.

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### **iii Even if the Documents are Considered CPR, Commission Rules, the NECA Seven Year Retention Guidelines Govern, or Carriers Can Estimate Unknown Amounts.**

The Auditors alluded to the Commission's Continuing Property Records ("CPR") rules and apparently concluded that the missing support was required, notwithstanding the requirements of 54.202(e). Consolidated disputes that the records in question were CPR covered under the Commission's CPR rules.<sup>13</sup> But, even assuming that the items are CPR, NECA has established a seven year guideline for retention of records underlying high cost data including data supporting line count filings, customer records, fixed asset property records, general ledgers, invoices for purchase of equipment and maintenance contracts.<sup>14</sup> As such, Consolidated disputes the Auditor findings that the underlying invoices and work orders for the assets in question must be kept in perpetuity, rather than for the seven years recommended by NECA.

Notwithstanding the classification of the possible assets as CPR, and whether the record retention requirement is indeed indefinite as proposed by the Auditors, it is inappropriate to invalidate all or some of an expense because it cannot be justified with an original invoice or work order as the Auditors have done. Certain assets, such as buildings, conduits or other physical plant may be in existence and operation for decades. It is unduly burdensome and unreasonable to require a carrier to retain the original documentation for those assets which may change ownership numerous times over the years.

Rather than simply invalidate an asset for want of support, the Commission's rules clearly allow, when a CPR cannot be properly determined, that the carrier in question can estimate the amount that is appropriate for use in its books.<sup>15</sup> When an asset is estimated, it is

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<sup>13</sup> 47 C.F.R. § 32.2000, *et seq.*

<sup>14</sup> See NECA Letter, at 1-2.

<sup>15</sup> 47 C.F.R. §64.3200(b)(2)(ii).

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subject to Commission review upon request.<sup>16</sup> In this instance, the asset values in the accounts are determined based on their value when acquired by Consolidated.<sup>17</sup> Thus, these booked amounts can be used as estimates and considered valid records in accordance with Section 64.3200(b)(2)(ii). To the extent that the Auditors believe the supporting data is insufficient under the Commission's CPR rules, then it is appropriate to consider the recorded CPR values that were given to Consolidated when it acquired the operating companies and their records of account. These records, including the cost that has been contained in the accounts, should be, at worst, deemed a sufficient estimate.

### **B. The Auditors Have Contradicted Commission Regulation by Attempting to Impose a Category Freeze on ICTC.**

The Auditors concluded that ICTC had improperly classified investments as loop improvement that should have been classified as investment in exchange trunks, toll facilities or host remote (ICTC Finding No. 3). In reality, however, the investments made in new facilities during 2004 and 2005 were primarily for the improvement and conditioning of the last mile facilities necessary for the extension of local loops, the lowering of ongoing maintenance costs, and the deployment of new services, such as Digital Subscriber Line ("DSL"). The location of the assets, between central offices and subscriber locations, clearly meets the Commission's definition of Category 1 facilities. As such, this finding should be reversed and the assignment to Category 1 should be retained in accordance with the expenditures.

The essence of the dispute is that the Auditors are incorrectly requiring ICTC to maintain the allocation percentages established in a 2003 categorization study in the 2004 and 2005 audit years with regards to Category 1 balances. This conclusion is contrary to FCC regulations, which specifically allow carriers to categorize assets based on direct assignment rather than

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<sup>16</sup> *Id.*

<sup>17</sup> Kay Callison Declaration, at ¶ 6 ("Callison Declaration"). Attached hereto as Exhibit F.

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allocation.<sup>18</sup> ICTC used the 2003 categorization study as a base for all Cable and Wire Facilities (“C&WF”) category balances, but used the expenditures from 2004 and 2005 to determine the Category 1 balance.<sup>19</sup> Since the total C&WF balance in 2004 and 2005 was greater than in 2003, ICTC assigned the additional capital expenditures based on the actual use of the assets. As described in greater detail below, the additional expenditures can all be properly demonstrated as Category 1 facilities. Nowhere in the finding did the Auditors actually argue that the amounts themselves were inaccurate.

FCC regulations make clear that assets can be categorized based on the actual location of, and services provided by, the facilities put into a network. The Auditors have created a requirement for ICTC to maintain the same allocation percentages over time as an unchanging ratio among the FCC’s four categories of cable and wire facilities. The Commission’s rules state that the assignment of assets between the various categories can be made “through the application of factor or direct assignment.”<sup>20</sup> ICTC chose direct assignment.<sup>21</sup> The Auditors believed that application of the factors from the 2003 study was more appropriate. But, such an allocation grossly distorts the actual causes of the differences in capital expenditures that occurred between the 2003 study and the 2004 and 2005 funding years.

ICTC initially categorized asset balances based on the 2003 categorization study. The increase in Category 1 balance during 2004 and 2005 was due to an increase in local loop investment compared to the 2003 study period. These capital expenditures were devoted to the conditioning of local loops, the extension of the loops, and the deployment of new services such as DSL. These additional expenditures would clearly be Category 1 investments based on their

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<sup>18</sup> 47 CFR. 36.151(a).

<sup>19</sup> Michael Shultz Declaration, at ¶ 7 (“Shultz Declaration”). Attached hereto as Exhibit G.

<sup>20</sup> 47 CFR 36.151(d).

<sup>21</sup> Shultz Declaration, at ¶ 7.

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location within the network and services provided. By comparison, no new expenditures were made for Category 2, 3 and 4 facilities.<sup>22</sup> The Commission's rules define Category 1 facilities as "C&W facilities between local central offices and subscriber premises used for message telephone, ... private line, [or] local channels."<sup>23</sup> The capital expenditures necessitated for line conditioning involved, exclusively, expenses that were performed between the central offices and subscriber locations.<sup>24</sup> As such, the expenditures that ICTC incurred in 2004 and 2005 should be assigned based on the actual location and purpose of the assets, in other words, to Category 1.

The Auditors seem particularly interested in retaining the allocations contained in the cost study they were given. This conclusion is directly in contradiction with the Commission's policies adopted as part of the 2001 separations freeze.<sup>25</sup> In the *Separations Freeze Order*, the Commission specifically permitted rate-of-return carriers like ICTC<sup>26</sup> to adjust their allocations among the various C&WF categories as investments changed, but required that price cap regulated LECs hold their percentage allocations among various C&WF categories and for jurisdictional assignment. Only jurisdictional assignments for rate-of-return carriers were frozen, which is not at issue here. In allowing rate-of-return carriers to change the assignment of investments to different categories, the Commission clearly noted that deployment of newer technologies such as DSL by rate-of-return LECs could have a significant change in underlying

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<sup>22</sup> *Id.* at ¶ 8.

<sup>23</sup> 47 CFR 36.152(a)(1).

<sup>24</sup> Shultz Declaration, at ¶ 9.

<sup>25</sup> *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No 80.286, *Report and Order*, FCC 01-162 (Rel. May, 21 2001). ("Separations Freeze Order").

<sup>26</sup> Although ICTC is presently regulated as a Price Cap LEC, for the periods in question (2004 and 2005), the company was a rate-of-return regulated LEC. This company, along with the other Consolidated entities, converted to Price Cap regulation in May, 2008. *Consolidated Communications Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-291, *Order*, DA 08-1026, (Rel. May 6, 2008).

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costs, and that such costs should be recovered as part of the USF High Cost system. Specifically, the Commission concluded:

[T]he Joint Board recognized that a categories freeze may have a negative impact on some rate-of-return carriers' current universal service high cost support levels... The investment levels in [certain categories] may increase for rate-of-return carriers as new technologies are deployed, such as facilities to provide DSL services. If the category relationships are frozen at the current year level, rate-of-return carriers may not be able to recover these costs in the future through increased loop support under the Universal Service High Cost Loop formula. In contrast, the Joint Board found that price cap carriers, due to their sheer size, have little fluctuation in the relative category levels within their investment accounts. In other words, the category relationships for price cap carriers generally remain relatively constant on an annual basis.<sup>27</sup>

By refusing to permit ICTC to change the ratios in the 2004 and 2005 funding years based on the actual investments made during that year by a rate-of-return carrier, the Auditors have effectively reversed FCC precedent by requiring ICTC to adhere to a standard (a categories freeze) that the Commission explicitly declined to enact for rate-of-return carriers.

As such, the finding of the Auditors should be vacated, and USAC directed not to recoup the High Cost Loop and Interstate Common Line Support for 2004 and 2005 as indicated in the ICTC Audit Report.

### **C. The Auditors' Understanding of Part 64 Tax Reconciliation is Legally Incorrect.**

The Auditors concluded that ICTC, TXU, and Fort Bend improperly excluded income tax calculations related to Part 64 cost allocation adjustments. The Auditors' determination is based upon an unwarranted and unreasonable interpretation of the Commission's rules and regulations. Therefore, ICTC Audit Finding No. 4, Fort Bend Audit Finding No. 5 and TXU Audit Finding No. 4, that income tax impacts were not properly recorded must be reversed with regards to the 2004 and 2005 support year.

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<sup>27</sup> *Separations Freeze Order*, at ¶ 19.

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In this finding, the Auditors have concluded that when carriers perform an accounting adjustment under Part 64 they must also determine the tax consequences of such adjustments at a level not contemplated by Generally Accepted Accounting Principles (GAAP) or the Commission's rules. The Auditors appear to base this interpretation solely on the opinion of KPMG's tax consultant. The KMPG consultant indicated that carriers commonly did not calculate the impact of the tax adjustment on their Part 64 adjustments, thereby showing that these types of adjustments are not common in the industry.<sup>28</sup> If these adjustments were completely flowed through under true GAAP accounting rules, the calculations would be extremely complex and impact multiple areas. The Auditors, however, avoid this issue by performing a simplified calculation, but without the double-sided accounting adjustments required under GAAP. The Auditors attempts at calculating the Part 64 adjustments account only for the income tax expense effect of the adjustment to operating expenses and deferred tax payable effect of the allocated plant assets.<sup>29</sup> The simplified calculations used by the tax consultant and the Auditors, while mathematically accurate, undermine and fall short of the more complex calculations required by GAAP procedures and rules, and by extension, the Commission's rules. Since these abnormal tax adjustments are inconsistent with standard industry practice and outside of the norms expected by the Commission, the finding must be reversed and rejected.

The interrelationship between the Commission regulations and GAAP is clear. The Commission has acknowledged the complexity of recording income tax expenses and has taken actions to promote administrative efficiency. For example, when establishing the regulations under Part 32 referenced by the Auditors in their reports, the Commission considered and

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<sup>28</sup> Janice Hester Declaration, at ¶ 9 ("Hester Declaration"). Attached hereto as Exhibit H.

<sup>29</sup> *Id.*

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explicitly decided against requiring multiple accounts to record income tax expense.<sup>30</sup> It recognized that too many accounts would be unnecessary and burdensome to carriers and that an acceptable and common industry practice is recording debits and credits into one liability account and one credit account.<sup>31</sup> Later, as the Commission implemented changes to Part 32 to incorporate new accounting procedures for income tax expenses, it explicitly noted that its Part 32 reporting requirements were adopted to confirm a requirement that accounting be done in conformance with GAAP and which avoid unduly burdening carriers with multiple accounting procedures.<sup>32</sup> As such, the only inquiry which the Auditors should conduct in order to determine if Consolidated is in compliance with the Commission's rules, is to determine whether Consolidated's Part 32 calculation for income taxes is mathematically correct and consistent with GAAP, which it is.<sup>33</sup> The Commission's rules do not expressly require recording income tax expense in the manner desired by the Auditors or the KPMG tax consultant.

As further evidence that the Auditors are incorrect with regards to their interpretation of Commission rules, they have created a finding which is admittedly inconsistent with GAAP, and thus the rules. The Auditors, while conducting a mathematically correct calculation did not conduct the further double-sided accounting calculations, reversals and reconciliations required by GAAP.<sup>34</sup> The result is a "simplified" calculation that is not fully consistent with GAAP, a fact conceded by the Auditor, after they noted the complexity that a full application of GAAP on their finding, and the difficulty that a carrier like Consolidated would have in doing the full

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<sup>30</sup> *Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules)*, Report and Order, 60 RR 2d 1111, ¶¶ 142-147 (1986).

<sup>31</sup> *Id.*

<sup>32</sup> *Amendment of Part 32 of the Commission's Rules to Implement Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes*, Report and Order, 9 FCC Rcd 727, ¶¶ 11-13 (1994).

<sup>33</sup> Hester Declaration, at ¶ 6.

<sup>34</sup> *Id.* at ¶ 9.

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reconciliation required by GAAP.<sup>35</sup> But, in so conceding the Auditors have essentially admitted that the finding they made would result in Consolidated being required to make a secondary, GAAP-like, but not entirely GAAP-compliant, set of calculations, the kind of which the Commission had clearly wished to avoid in establishing its accounting rules.<sup>36</sup> The Auditors, in essence, have determined that they believe an adjustment is necessary, but don't complete the extremely complicated calculations necessary to do the computations GAAP would require. It is precisely for this reason that the Commission does not require carriers to do the adjustments (and related computations) that the Auditors believe are necessary.

Consolidated further disagrees with the Auditors' conclusions regarding the proper tax rate used in its calculation of deferred income taxes. Consolidated reviews and re-evaluates its deferred tax rate quarterly with senior management of the Tax Department.<sup>37</sup> These calculations are also reviewed quarterly by independent consultants and independent auditors.<sup>38</sup> The Auditors, however, believe that the rate used was not correct. Consolidated's method of accounting for taxation is to perform a quarterly adjustment of the deferred tax rate based on an estimate of the tax rates expected to be in effect during the periods in which the expected temporary differences reverse. This method is sufficient, and GAAP-consistent. Changing the tax rate on deferred tax expenses causes flow-through effects not only the balance sheet, specifically in the deferred tax payable account, but also the income statement, through a change in the deferred tax expenses.<sup>39</sup> The result of the Auditors switch in tax rate creates a deviation from GAAP-consistent calculation of deferred tax expenses, to a calculation that, while

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<sup>35</sup> *Id.* at ¶ 9.

<sup>36</sup> *See* note 34 (referencing FCC's 1994 Accounting Order).

<sup>37</sup> Hester Declaration, at ¶ 6.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at ¶ 7.

mathematically correct, is not consistent with the overall audited financials of Consolidated, which are kept in accordance with GAAP.

Consolidated disagrees with the Auditors' findings and recommendations regarding its deferred tax calculations. The complex GAAP accounting rules for income taxes require that any adjustments to the deferred tax rate also requires adjustments to the balance sheet deferred taxes payable and also the income statement deferred tax expense. It is improper and erroneous to use the "simplified" calculations recommended by the Auditors since they fail to make all of the necessary adjustments required under GAAP. By directing Consolidated to deviate from GAAP, the Auditors have created a conclusion which misapplied the Commission's Part 32 requirements, and thus should be rejected.

**D. The Auditors Erred in Concluding that ICTC's Part 64 Allocation Between Regulated and Unregulated Expenses was Improper.**

The Auditors concluded that ICTC improperly allocated expenses between regulated and unregulated entities. The Auditors base this conclusion on a study that the company was urged to create after it was told they may otherwise face a negative audit finding.<sup>40</sup> While this study was conducted in good faith, using the information that Consolidated had available to it, it necessarily relied on actual revenue as opposed to projections that would have been done for the original study. The "study" that the Auditors used in the audit was constructed using actual data from the time period under review during the audit.<sup>41</sup> This study should not be considered binding on Consolidated as it was merely intended to provide the Auditors with some information after they intimated a negative result if a study was not created for them.<sup>42</sup> As this data was provided purely as informational to the Auditors, the fact that allocations done in

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<sup>40</sup> Shultz Declaration, at ¶ 10.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

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accordance with a study using estimates do not match an after-the-fact analysis using actual expenditures should not be the basis for a negative finding. While Consolidated sets forth the following objections to this finding, it also reserves its right to make further appeals after the Commission has issued its response to USAC's request for guidance on the recovery of funds as a result of the Acquisitions.

ICTC's Part 64 allocation methodology should not be set aside merely because Consolidated does not have the underlying documentation to demonstrate support for the apportionment factors. The underlying data is not available because of record retention related, in part, to the Acquisitions.<sup>43</sup> Due to the different systems in place following the TX Acquisition, Consolidated maintained two separate allocation methodologies in 2004 and 2005; one for the Illinois entity, ICTC, and one for the Texas entities, Fort Bend and TXU. ICTC's allocation model was developed prior to the ICTC Acquisition by personnel that are no longer company employees and was based on 2003 underlying data.<sup>44</sup> Consolidated was not able to locate the 2003 underlying data for ICTC's allocation model, but ICTC's allocation model was developed based on data available at the time. As discussed herein in Section A above, Consolidated had no obligation to maintain the 2003 underlying data under the Commission's record retention requirement for documentation related to universal service high-cost fund. ICTC's allocation methodology also should not be set aside because the 2003 underlying data was collected prior to the ICTC Acquisition.

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<sup>43</sup> Consolidated further notes that the monetary effect of these findings were stayed pending a USAC request for further clarification from the Commission on the effect of the acquisition of these entities by Consolidated. (*See, e.g.,* Fort Bend Audit Report, USAC Management Response, at 1; ICTC Audit Report, USAC Management Response, at 1; TXU Audit Report, USAC Management Response at 1.) Until such time as the Commission rules on this request from USAC, that issue is not ripe for appeal by Consolidated. As such, Consolidated reserves the right to appeal that decision after a decision is rendered, at a future date.

<sup>44</sup> Shultz Declaration at ¶ 10.

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In addition, it was unreasonable for the USAC auditors to utilize the model that had been prepared at their request with prospective 2005 data. As explained in the Beneficiary's Response, the original model used for the 2004 and 2005 cost allocation process provided the *best* representation of the way the business operated.<sup>45</sup> During the audit, the Auditor's implication of a negative finding effectively compelled the company to create a "what if" study using actual data, which, of course, resulted in a study that did not match the study conducted in 2003 on which the 2004 and 2005 support years are based.<sup>46</sup> This original allocation model was developed based on data available at the time whereas the allocation model prepared at USAC's request was not necessarily applicable to 2004 and 2005, but a forward looking view of possible business changes including rolling out new services. This model was, and is, the appropriate basis for calculating USF support under Commission Rules.

### **E. Fort Bend and TXU Audit Results Should Be Netted Against Each Other.**

The Fort Bend and TXU entities were acquired together by Consolidated, both provide identical services in the State of Texas and had nearly identical findings in each of their audit reports. Specifically, the Auditors concluded that both Ford Bend and TXU lacked supporting documentation (Ford Bend and TXU Findings No. 1), misclassified and had unsupported expenses (Ford Bend and TXU Findings No. 2), Part 64 cost allocation adjustments (Fort Bend and TXU Findings No. 3) and income tax and deferred operating income tax errors (Fort Bend Finding No. 5; TXU Finding No. 4).

Due to their common prior ownership and management, both Fort Bend and TXU used the same systems and accounting procedures.<sup>47</sup> These entities should not be unduly penalized for having the same alleged errors. Consolidated respectfully asserts that the audit recovery

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<sup>45</sup>

*Id.*

<sup>46</sup>

*Id.*

<sup>47</sup>

Callison Declaration, at ¶ 7.

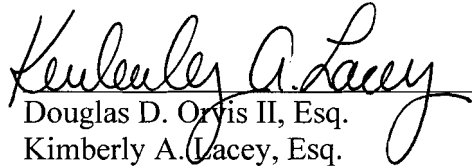
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totals, largely countering one another, based upon similar underlying procedures, should be netted across both Fort Bend and TXU.

**III. CONCLUSION**

For the foregoing reasons, Consolidated Communications Holdings, Inc., on behalf of its subsidiaries Consolidated Communications of Fort Bend Company, Illinois Consolidated Telephone Company and Consolidated Communications of Texas Company, respectfully requests that the Bureau reverse the portions of the audits identified above, and direct the Universal Service Administrative Company to refund any recouped USF distribution to Consolidated, and to improve their processes for these audits in the future.

Respectfully submitted,

A handwritten signature in cursive script, reading "Kimberly A. Lacey", is written over a horizontal line.

Douglas D. Orvis II, Esq.

Kimberly A. Lacey, Esq.

BINGHAM MCCUTCHEN, LLP

2020 K Street, N.W.

Washington, D.C. 20006

Tel: (202) 373-6000

Fax: (202) 373-6001

Email: [douglas.orvis@bingham.com](mailto:douglas.orvis@bingham.com)

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**Exhibit A**

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**Exhibit B**

**(CONFIDENTIAL - EXHIBIT HAS BEEN REDACTED FROM PUBLIC FILING)**

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**Exhibit C**

**(CONFIDENTIAL - EXHIBIT HAS BEEN REDACTED FROM PUBLIC FILING)**

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**Exhibit D**

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